competition; providing open access to the NII by consumers and service providers; preserving and advancing universal service to avoid creating a society of information haves and have nots; ensuring flexibility so that the newly-adopted regulatory framework can keep pace with the rapid technological and market changes that pervade the telecommunications and information industries.

In view of the Administration's telecommunications reform efforts, it is imperative that public policy initiatives must be taken to remove artificial and unnecessary restraints and allow LECs to invest their vast experience and knowledge so they can, in unison with other participants, build the NII. The LECs have been building parts of the information superhighway based on the capabilities of the public switched network (PSN) to meet the diverse needs of their customers, including end users, information service providers and applications providers. The PSN can efficiently serve as the foundation of the NII, if changes are made to regulatory paradigm to encourage investment.

SWBT supports the concept of an NII outlined in the Clinton Administration's NII Agenda for Action. Without a regulatory framework that enables the LECs to equitably compete, and to retain the benefits of their efficiencies and investments, the turn of the century will find us looking back on the NII as an unfilled promise.

Given that the Commission's goal is to support the development of a ubiquitous NII, the LEC price cap plan should be revised with several principles in mind. In general, these revisions should eliminate regulation of LEC earnings, provide for pricing flexibility, and provide regulatory parity, whereby regulatory constraints for incumbents are relaxed rather than imposing existing constraints on new entrants.

One of the goals of the Commission's price cap regulatory structure is to provide increased incentives to invest and modernize the telecommunications network, and indeed, the price cap LECs have invested about $60B in new plant and equipment over the past three years under price caps. However, the current price cap plan should be changed to encourage increased investment. Investment in telecommunications is just one of many areas in which companies, individuals and shareholders can invest. How much they will invest in telecommunications depends on the returns and risks they expect to realize from that investment.

The following examples illustrate that when significant relief from regulators is realized (or even anticipated) investment levels are increased significantly:

- U.S. WEST and NYNEX believe programming offers opportunities and are investing $2.5B and $1.2B in Time-Warner and Viacom (respectively).

- When the United Kingdom liberalized its regulatory policies for communications, it immediately realized billions of dollars in new investments from U.S. companies, including the Regional Bell Operating Companies (RBOCs). (For example, Business Week, September 27, 1993, estimates U.S. companies will invest $10B over the next few years in the U.K.'s telecommunications infrastructure.)

- When a federal judge ruled that the cable-telco cross-ownership prohibition was unconstitutional, stock prices of all the RBOCs rose on the belief that regulatory relief was forthcoming. When that same Judge ruled that the Order applied only to Bell Atlantic and not the other RBOCs, the stock prices of the other RBOCs fell.

- As Congress and the Commission re-regulated the CATV industry, the value of cable stock plummeted and proposed investments and mergers crumbled.

- The RBOCs, as a group, have indicated they would accelerate $100B in infrastructure investment (i.e., $450B vs. $350B) over the next 22 years if they were afforded relief from cable-telco cross-ownership and Modification of Final Judgment (MFJ) restrictions.

The price cap performance review, through the incentives provided (or not provided), will determine the extent to which LECs will be encouraged to accelerate a modernized infrastructure. The marketplace should be the testing ground for the wisdom and returns that are associated with investment plans, and the Commission should avoid specific technology or investment mandates.

a. Infrastructure Development And Earnings Regulation Are Related.

The shortcomings of earnings regulation have been well documented in previous proceedings. Particularly onerous to the LECs are the disincentives to new investment that are associated with earnings regulation. Under cost-plus regulation, when a LEC reduces costs through innovation and efficiency, it is penalized by revenue reductions. If a carrier successfully introduces new services and increases earnings above some determined level, the additional earnings are not retained by the carrier. In either event, there is a significant disincentive for carriers to invest in infrastructure that reduces costs or brings new services to customers.

As currently implemented, the LEC price cap plan uses earnings on a rate base as a benchmark for sharing profits with customers. In this respect, there is little practical difference between this plan and other forms of earnings regulation that discourage new investment by focusing on earnings. Thus, the Commission should revise the current plan and place greater emphasis on efficiency and service innovation, both of which benefit consumers.

b. Infrastructure Development And Pricing Flexibility Are Related.

Increased pricing flexibility for LECs will also promote infrastructure development. Under the current plan, LECs are subject to burdensome regulatory procedures in order to introduce new services or make price changes. However, new entrants are not required to file comprehensive tariffs with detailed cost and price information and are readily able to offer services under varying prices, terms and conditions. As a result, market demand is being increasingly met by those not subject to regulatory constraints. As LECs lose key customers to competition, the burden of supporting the public switched network must increasingly be borne by remaining customers, primarily residential and small business.

Large customers, and any customer with the means to purchase alternative services from competitors, can most likely obtain the advanced telecommunications capabilities that they require. In contrast, the overwhelming majority of customers are dependent on the public switched network for services. These customers are likely to be deprived of the modern telecommunications capabilities that would be available through an NII. Pricing flexibility would allow LECs to meet competition by adjusting prices and offering more terms and conditions in those areas where market conditions dictate.

To support increased investment and economic growth, the plan should be revised to provide regulatory parity. The demands of a naturally competitive market create a greater variety of options for customers and greater business opportunities for all providers of telecommunications services. Therefore, when competitive providers are allowed to enter telecommunications markets, the public interest is best served by relaxing the regulatory constraints on existing providers.

2. Universal Service Should Be Promoted.

The Commission has demonstrated through its experience with the interexchange marketplace that a pro-competitive policy can be pursued while maintaining universal service goals. This was possible due to the explicit recognition of support flows implicit in predivestiture rates and by setting the level of End User Common Line (EUCL) charges to recover some of these support requirements. This was an initial move toward more economic pricing. However, as a result of today's price cap plan and how it was implemented, the current access charge structure and rates still contain pricing distortions related to universal service support flows. As a result, the pattern of relative rates is different from the pattern a pure market outcome would produce, i.e., LEC access prices are inefficient and do not reflect their relative incremental costs of production.

In a market where access services are subject to increasing competition, there will no longer be any one carrier or group of carriers that can be relied upon to generate funding for universal service. The current regulatory framework, which relies solely on exchange carriers to fund certain aspects of universal support, is not consistent with the development of competition. The funding for interstate support mechanisms to ensure universal service should come from all market participants in a way that eliminates market distortions. SWBT recognizes that some aspects of achieving the necessary solutions to universal service may be beyond the scope of the price cap review. However, the elimination of many of the service category and subindex banding restrictions of the current plan and adoption of the functional basket and service groupings recommended herein would allow the price cap LECs to move their access prices toward more efficient levels, while retaining the regulatory price cap restraint on overall prices.[107]

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[107] This is consistent with the Commission's original expectation for the LEC price cap plan. LEC Price Cap Order, para. 35.

3. The Introduction of New Services and Technologies Should Be Promoted. (Baseline Issue 8A)

As noted above, Congress has recognized the importance of encouraging the introduction of new technologies and new services.[108] The Commission recognizes that the existing price cap framework does not further this objective; in fact, it actually impedes it.[109] Many new services do not readily fit the existing rate structure and the process for obtaining a waiver or changing the rules is costly, time-consuming and highly uncertain. As a result, these new services reach the public slowly, if at all.[110] Even in the absence of access competition, this failure merits change.

Any new plan should minimize regulatory impediments and should facilitate reliance on market incentives to develop new offerings. The opportunity for innovation should be actively pursued, rather than treated as a regulatory nuisance. The Commission's policies should encourage all access providers, including exchange carriers, to: introduce new services to satisfy customers' needs; adjust service features, terms and prices in response to customers' needs; tailor solutions to the needs of individual customers; and make efficient use of the most advanced technology.

By the Commission's own definition, new services increase the range of alternatives available to consumers while maintaining all the service options available to

[108] 47 U.S.C. 157(a).

[109] NPRM, para. 79 (Current rules "generate delay and increase the costs of introducing new services. They may also inhibit the LECs' ability to compete with services offered by CAPS . . . reviewing new service cost support is often difficult and controversial.")

[110] See Appendix NS.

consumers before the new service was offered.[111] Consumers, therefore, can be made no worse off with the introduction of the new service than what they were before a new service was introduced, regardless of the price that is charged for the new service; viable alternatives already exist for the new service.

If a provider charges prices that are too high, very few, if any, customers will buy the service. The provider would then have to lower the price, or discontinue the product if it could not cover its costs. In neither case would customers be worse off than they were before. But if the provider could offer the service at a price at which it can stimulate sufficient demand to offer the service profitably, then those customers choosing the new service would be better off -- otherwise they would not choose the new service, but would keep their existing service arrangements.

4. Balanced Competition In Access Markets Should Be Supported.

Competition produces numerous public interest benefits, including improved service quality and availability, lower prices, and increased innovation in telecommunications offerings.[112] The full range of consumer benefits resulting from a competitive policy can only be realized if all market participants, including the incumbent firm, are allowed to compete effectively. The Commission staff found:

> if only LECs are subject to rigid rate structure rules, they will be at a competitive disadvantage in their ability to respond to the market. LEC customers may choose to take service from a competitor in order to avoid artificially high LEC rates or to

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[111] LEC Price Cap Order, para. 314.

[112] Access Reform Task Force, Federal Perspectives on Access Charge Reform: A Staff Analysis, April 30, 1993, (Staff Analysis) p. 29.

> obtain alternative rate structure options. Loss of customers for these uneconomic reasons has undesirable effects on access rates. As customers leave, the fixed costs of the network must be borne by fewer customers. Access rates would therefore increase for those customers that remained on the network, further reducing the LECs' ability to compete effectively.[113]

Under current Commission policies, competition is anything but balanced. Exchange carrier competitors are able to establish individualized prices for services for any customer, including term and volume discounts, without any cost support material, without any constraints on rate structure or rate levels, and without any restrictions on establishing new rate elements. LEC competitors are currently allowed to file tariffs with a range of prices listed.[114] The only way to achieve balanced competition is to treat all competitors equally in markets where competition exists.

5. Efficient Use Of The Network Should Be Promoted.

Efficient use of the network has consistently been a Commission objective.[115] Regulation should emulate competition such that the most valuable mix of goods and services is produced at the lowest possible cost to society. When regulation leads to prices that are different from those a competitive market would naturally produce, purchase decisions are

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[113] Staff Analysis, pp. 34-35.

[114] The Commission's Rate Range Order, which did not explicitly allow all carriers to file range-of-rates tariffs is being reviewed by the Court of Appeals. Southwestern Bell Corporation v. FCC, appeal docketed, D.C. Cir. Case No. 93-1562.

[115] MTS and WATS Market Structure, Further Notice of Proposed Rulemaking, CC Dockets No. 78-72 and No. 80-286, released July 2, 1986, para. 1.

distorted and resources are used inefficiently.[116] Over time, several aspects of the Commission's access charge plan, such as the introduction of EUCL charges, have reduced some price distortions and contributed to network efficiency. However, the current LEC price cap plan and access framework sends increasingly incorrect price signals because it has not kept up with market changes or with the LECs' need to adjust prices freely in response to competitive market pressures. Increased use of economic pricing principles is important if network efficiency is to be fostered. This objective can be met through a new access framework that promotes timely market responsiveness by exchange carriers; reduces the effect of uneconomic policies on rates; and relies on a broad-based contribution mechanism by all market participants to fund the support flow necessary to support universal service.

6. Unreasonable Discrimination Should Be Prevented.

The Commission must permit price differentiation so long as such prices are not unreasonably discriminatory as defined by the Communications Act.[117] Currently, customers in different states can pay different rates for "like" services. In a single state, customers of a single exchange carrier pay the same rates for "like" services even though the services provided to each customer may have significantly different underlying costs. Price differentiation is

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[116] This is denoted as a second-order efficiency loss, or an allocative inefficiency. In addition, when a high-cost provider enters a market, enticed by an artificially high regulatorily-determined price, technical efficiency (first-order) is compromised as services are no longer produced at the lowest cost. A clear definition of allocative efficiency can be found in the MIT Dictionary of Economics (David W. Pearce ed., 1986), pp. 13-14.

[117] The Commission permits reasonable price discrimination now via approval of the tariffs of the alternative access providers. See Section I.C.3. of Appendix COMP.

required in competitive markets.[118] Commission policies should not prohibit price differentiation in competitive markets, recognizing that competitive markets are consistent with reasonable price differentials.

7. Regulatory Burdens Should Be Minimized.

The LEC price cap plan should not place unnecessary administrative burdens on customers, carriers or regulators. Such burdens should be viewed as unreasonable. Rules and requirements should be easily understandable by all affected entities. The cost of administering any regulatory scheme should be kept to a minimum.

Because of its rigidity, the current LEC price cap plan has increasingly required an unreasonably extensive and continuing oversight by the Commission. A framework which is more flexible and does not result in frequent rate investigations, rules changes or waivers to accommodate new developments would reduce the cost of regulation for carriers and consumers, as well as the administrative burden now borne by the Commission.

B. The Specifics Of The USTA Proposal Are Appropriate.

SWBT strongly supports the USTA comments filed on this date in this proceeding and recommends that the SWBT and USTA comments form the template for the Commission's price cap performance review.

1. Rate Structure Reform Is Needed. (Baseline Issues 8A and 8B)

The Communications Act of 1934 places the burden of proof on any party opposing a new service on the grounds that implementation of the new services would be

[118] The Commission has recognized this need -- but only to a very limited extent -- with the current zone pricing plan.

contrary to the public interest.[119] As a primary objective for the price cap rules, the Commission itself established that LECs should be encouraged to be "more innovative in the development and introduction of new, high quality services."[120] Unfortunately, many elements within the Commission's rules and regulations actually impede the development and introduction of new services. These impediments can be categorized as: structural, administrative and profitability.

a. Structural Impediments Should Be Removed.

The current structure was adopted over a decade ago, and does not reflect technological advancements which have occurred since then.[121] Services that do not fit the old structural requirements become "square pegs trying to fit round holes."

The specific and prescriptive nature of the structure necessitates a cumbersome waiver process that can result in significant delays in the introduction of new services.[122] The Commission's rules and regulations require that new services be filed on 45 days' public notice. Any delays as a result of waiver requirements are in addition to this notice period requirement. Through suspensions and deferrals, new services can be delayed nine months or more. During this period, competitors, aware of LEC costs and rates, are free to develop and introduce their own substitutable service offerings. At the same time, LEC competitors are able to introduce

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[119] 47 U.S.C. Section 157(a).

[120] NPRM, para. 73.

[121] Staff Analysis, p. 16.

[122] Appendix NS lists a sampling of recent LEC Part 69 Waiver Requests demonstrating the impact that these delays can generate.

new services with one day's notice, providing competitors a distinct and significant competitive advantage.

Moreover, this outdated structure may preclude the introduction of future services.[123] As with the waiver process, the LECs cannot, with any degree of certainty, predict the outcome of their requests to offer new services that do not fit "the round holes." More importantly, the delays and uncertainty associated with new service introductions are intolerable for most customers.[124] Ultimately, these rules serve only to prevent LECs from responding to specific customer needs and therefore do not serve the public interest.

b. Administrative Impediments Should Be Removed.

The Commission's rules and regulations confer burdensome requirements (such as voluminous cost support, overhead allocation justifications, and detailed demand forecasts) and additional costs on LECs which are not shared by their competitors. These requirements impose an unnecessary administrative burden and an unreasonable competitive disadvantage on the LECs. The LECs should be able to introduce new services without the administrative burdens currently imposed, relying instead on competitive market forces and customer options to determine the proper price.

c. Profitability Impediments Should Be Removed.

Profitability is the driving force behind any business decision. Developing a new service often entails considerable research and development costs, and substantial uncertainty

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[123] Appendix NS lists some anticipated new services and the foreseeable issues in introducing these new services.

[124] SWBT's Free to Compete study demonstrates this point.

regarding a great number of factors. The more innovative the new service is, and the more it relies on unproven technology and uncharted markets, the greater the risk of falling short of product expectations or product failure. Product development can be very risky because it can be quite costly and there are no guarantees of product success.

Firms will undertake such risky investment only if they can reasonably expect to earn a financial return from the product. Thus, substantial profits following the introduction of a new service are reasonable as a reward to the provider of the new service for undertaking the risk, research and development necessary in bringing a new service to the market. Precluding the firm from earning relatively high profits in the short run would diminish the firm's incentive to undertake the risks of research and development of new services. This fact was recognized by the Commission in concept when it allowed new services to remain outside the price cap for a brief time.[125] However, the Commission's sharing requirement and initial price constraints substantially reduce these incentives, because they severely dampen the rewards for undertaking risky and potentially costly innovation.

d. Adoption Of The USTA Proposal Would Remove The Impediments To New Service Introduction.

USTA's proposal requests that the Commission address the antiquated interstate access charge plan. The instant proceeding affords the Commission an opportunity to begin addressing many of these concerns.

In order to facilitate the introduction of new services, SWBT recommends that rate elements, other than those classified as public policy elements, would no longer be codified.

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[125] LEC Price Cap Order, para. 319.

SWBT recommends a new price cap basket structure into which similar access functionalities can be logically grouped. Appendix BASKET details the proposed structure. Such a regime would eliminate the need for waivers of rate structure requirements for services outside the Public Policy Basket. It would not allow any existing services to be eliminated without the appropriate regulatory review.

Furthermore, new services should carry the presumption of lawfulness as called for in the Communications Act. The burden of proof should be upon the intervening entity to demonstrate that the offering would not be in the public interest. Too often LEC competitors are able to game the regulatory process by simply petitioning against the LECs' introductions of new services. Potential customers may use the process as a means to leverage the price lower. While intervention is a reasonable process for protecting the public interest, it is the Commission's responsibility to ensure that the process is not abused.

Additionally, the notice intervals for new services should be minimized. New services should be allowed to become effective on 45 days' notice in less competitive markets and on 14 days' notice in competitive markets. Markets experiencing an intermediate level of competition should allow new services to become effective on 21 days' notice.[126]

2. Pricing Flexibility Should Occur Through Pricing Reform. (Transition Issues 1B, 1C, 1D, 2, 3; Baseline Issues 2, 8B, 9B)

SWBT recognizes that competition is not ubiquitous, but that there are geographic markets of varying degrees of competition. Customers within competitive markets should not be denied the benefits that an otherwise unregulated, competitive market would yield. SWBT

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[126] USTA Petition, p. 33. These proposed notice periods are clearly reasonable given the one-day notice period available to the LECs' competitors.

supports a dynamic framework for modifying regulatory oversight commensurate with changing market conditions.

The USTA proposal accounts for the evolution of competition and provides the Commission with a means to disengage itself in concert with that evolution. Regulatory changes are accomplished through a pre-established process, thereby eliminating the need for a lengthy proceeding each time regulatory change in a particular market area is warranted.

The following outlines the proposed market area classification process, the price cap basket structure, cost and demand support, and notice intervals that the Commission should adopt to effect a regulatory model which is responsive to competition.

a. Market Areas Should Be Defined.

Proper definition of a market includes both a product and a geographic dimension. With regard to the latter, SWBT supports the definition of a market area as the geographic area served by one or more wire centers. Using wire centers as the geographic basis for competitive analysis is appropriate because of the nature of telecommunications services and the evolution of competition within the marketplace. Competition is not ubiquitous throughout the marketplace. LECs are bound to study area or zone pricing, while LECs' competitors have the profound advantage of provisioning services in only the most lucrative areas within those markets. Thus, competition is most likely to expand outward from high-density markets as competitors extend their facilities and supply from the most lucrative sites to proximate customer locations. The process naturally accelerates as each extension of the network may bring an increasing number of potential customers within economic reach of the competitors' networks.

Dealing with expanding competition on an incremental basis (e.g., on a building-by-building basis or on a customer-by-customer basis) would be unreasonably time-consuming and laborious. On the other hand, to analyze geographic areas larger than a wire center (or group of wire centers) may not provide the necessary regulatory safeguards in some applications due to the nonubiquitous nature of competition. Therefore, as Schmalensee and Taylor discussed in their comments on the USTA proposal, "[f]or practical purposes, then, the LEC wire center is the smallest possible geographical area to which market power analysis can practically be applied."[127] The presence of a competitor's network in a wire center is indicative of the viability of competition within that wire center.

With regard to the product dimension of the market, all services that are reasonable substitutes should be considered part of the market and afforded the same regulatory treatment. For access, this would include all access services terminating or originating within the geographic market area. Schmalensee and Taylor find that alternative providers' "networks can be used to provide any desired set of services."[128]

The regulatory framework must ensure that pricing decisions in one market do not harm customers in other markets. The main concern is whether the incumbent firm is able to offset price reductions in competitive markets with price increases in less competitive markets. Reliance on explicit price constraints within Initial Market Areas (IMAs) and Transitional Market Areas (TMAs) addresses such concerns by implementing market area band indices to preclude such pricing tactics. Moreover, expanded downward pricing is accomplished without

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[127] Richard Schmalensee and William Taylor, "Comments on the USTA Pricing Flexibility Proposal," (Schmalensee and Taylor), p. 23.

[128] Schmalensee and Taylor, p. 25.

an increase in the LEC's ability to increase prices. The net result, as supported by Schmalensee and Taylor, is that the "additional pricing flexibility provided in a TMA thus does not increase the ability of the LEC to subsidize carrier access services in competitive areas at the expense of carrier access customers in less-competitive areas."[129]

Within Competitive Market Areas (CMAs), services would continue to be regulated under applicable Title II regulations,[130] but they would be removed from the existing regulatory regime (e.g., price cap regulation). General tariff rates would continue in effect for services not purchased from the LEC under contract. All LEC prices for competitive carrier access services would be required to be set at or above their incremental cost.[131] Therefore, for each service, both a legitimate price floor and a price ceiling exist de facto. Whereas incremental cost would serve as the price floor, the existing tariff rates would naturally serve as the price ceiling because customers clearly would not be willing to purchase services at contract prices that exceed the existing tariff rate. By removing these services from price cap regulation, LECs effectively preclude revenue shifting between these services and the remaining LEC services.[132] The issue therefore is whether the effects of these flexibilities could be used to exercise market power. Schmalensee and Taylor find that because of the

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[129] Schmalensee and Taylor, p. 27.

[130] Legislation could affect the definition of Title II communications services and the concomitant regulations.

[131] Given the increasingly competitive access markets, demand and cost support data utilized in support of a price floor is competitively sensitive and must be afforded proprietary treatment.

[132] Complete removal of the financial incentives for the carrier to cross-subsidize requires the removal of earnings sharing on IMA and TMA services. CMA services would also not be subject to earnings sharing.

homogenous, wholesale nature of the access market and because of the intense concentration of demand primarily among a handful of technically well-informed, sophisticated and financially motivated customers, competition for those services is likely to be extremely vigorous.[133] Therefore, the 25 percent availability standard is acceptable, especially in light of recent economic standards as established in U.S. Department of Justice Merger Guidelines and the Cable Act of 1992.[134]

In conclusion, Schmalensee and Taylor found that the benefits from the proposed flexibilities are important. Specifically, they found the following:

> The USTA criteria will engender economic efficiency incentives that support the FCC's stated goals for carrier access regulation. Customers that would be able to purchase access services from the LECs, CAPs or other competitors at the most efficient and lowest price are the beneficiaries of the plan. Without the proposed pricing flexibility for all LECs, the benefits of competition will not accrue to customers and carrier access competition may raise industry costs and prices rather than lowering them.[135]

b. Price Management Should Occur Through A New Basket Structure.

To manage prices effectively, an appropriate price cap basket structure must be implemented. The existing price cap basket structure is based on the existing outdated Part 69 service categories. With the elimination of the service category codification defined in the existing Part 69 rules, the current price cap basket structure is no longer appropriate. Instead, the current service application structure should be replaced with a basket structure based on

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[133] Schmalensee and Taylor, p. 35.

[134] Schmalensee and Taylor, pp. 34-36.

[135] Schmalensee and Taylor, p. 44.

functional groupings. Market area categories under each of the baskets will separate services into less competitive and transitional markets. As markets become increasingly competitive, LECs would be able to move wire centers into the appropriate market area categories. This structure could readily adapt to changing market conditions without the need for constant extended regulatory proceedings for revision, rebalancing or realignment. Rate elements can be grouped for price management purposes into baskets which are consistent with the functional service groupings (i.e., access categories) proposed for Part 69. The revised baskets would allow rates for equivalent functions to be grouped in the same basket.[136] Appendix BASKET depicts the proposed price cap basket design.

The following baskets are proposed for incorporation in FCC Part 61 as a result of this price cap review:

Transport - This basket could include all interoffice transport, regardless of whether the transport facility is associated with a switching function; all facilities provided under interstate access tariffs between the local serving office and a customer's premises (this would include current special access channel terminations, as well as entrance facilities between serving wire centers and customers' premises); any features associated with transport, such as line conditioning; and the interconnection Charge.

Switching - This basket could include all current and new switching functions, as well as features associated with switching, such as signalling and data base services.

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[136] A recent example of such grouping around functional lines was the Commission's re-definition of price cap baskets, combining switched transport and special transport into the trunking basket. See Transport Rate Structure and Pricing, Second Report and Order, CC Docket No. 91-213, released January 31, 1994.

Public Policy - This basket could include the EUCL Charge, Carrier Common Line (or substitute recovery mechanism), and Special Access Surcharge.

Other - This basket could include any other rate elements which do not fit in the Transport, Switching, or Public Policy baskets.

A price cap category for each IMA would be established within the Switching basket and the Other basket. Separate Digital and Other price cap categories for each IMA would be established within the Transport basket. A single price cap category containing all applicable TMAs would be established within each basket. The Public Policy basket would not contain IMA and TMA category designations. However, separate price cap categories may be established for elements within the Public Policy basket, allowing individual price management. This price cap architecture would provide a safeguard against revenue shifting between the IMA and the TMA. The Crossconnect Charge (for collocation) is managed outside of price caps.

c. Ongoing Price Management Should Occur Through The Use of IMAs, TMAs and CMAs.

Separate prices will be established for services within an IMA, a TMA and a CMA. Price changes within the Public Policy basket and Public Policy access category would be subject to rules established specifically for each element as shown below. Price cap indexes, applicable to price cap companies, restrain LECs' ability to increase IMA prices to offset declines in TMA prices.[137] Price cap indexes are established for each of the aforementioned baskets, except for the Public Policy basket.

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[137] In a parallel proceeding applicable to non-price cap LECs, these same types of pricing flexibilities should be granted to non-price cap companies. The non-price cap companies would still be constrained by traditional revenue requirement limits.

Consistent with current price cap regulation, the basket Average Price Index (API) cannot exceed the basket Price Cap Index (PCI). Individual IMA and TMA category Market Area Band Indexes (MABIs) would be calculated and would have an upper limit of 5 percent relative to changes in the basket PCI. The lower limit for TMA categories would be 15 percent while the lower limit for IMA categories would be 10 percent. A LEC may file below-band rates by producing an incremental cost study which demonstrates that the requested rates are above costs. Prices may be adjusted either upward or downward to the extent that they comply with all applicable pricing safeguards and rules.

Once a TMA has been established, LECs would be able to respond to a request for proposal (RFP) from a customer with a contract tailored to meet the customer's needs. Rates for services in a CMA would be outside of the LEC price cap plan. Market constraints would replace price caps as the control mechanism to ensure reasonable rates. Absent legislation to the contrary, CMA services would continue to be regulated Title II communications services.[138] Contract carriage would be permitted for any service offered in a CMA. The revenue and cost associated with TMA and CMA contracts would not be included in price cap or revenue requirement calculations for establishing average prices.

Price management in the Public Policy basket would be slightly different from the existing Common Line basket. One difference is that the CCL minute of use equation would be eliminated, consistent with the goal of eliminating rate element codification, and replaced with an equivalent API calculation that would facilitate more flexible CCL rate design. Absent

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[138] Title II requirements include tariff filings for CMA services and provide customers with potential regulatory relief through the complaint process.

specific rules changes, the EUCL would continue to be developed from cost allocation rules. Thus, the EUCL would continue to be the only element that requires cost allocations for ongoing price management purposes. The residual Interconnection Charge (IC) would be price managed under the Transport basket.

d. Filing Requirements Should Be Relaxed.

Consistent with the recognition that explicit regulatory oversight should be relaxed where competition is greater, filing intervals decrease as services move from IMAs to TMAs and to CMAs. Table 6 below details the recommended filing intervals:

Table 6
Recommended Filing Intervals

Type of Filing	Markets	Interval
Annual Tariff Filings	IMA, TMA	90 days
Within-Band Filings	IMA, TMA	14 days
Above-Band Filings	IMA, TMA	120 days
Below-Band Filings	IMA, TMA	45 days
New Services	IMA TMA CMA	45 days 21 days 14 days
Restructure	Any	21 days
Price Changes in a CMA	CMA	7 days
Contract Services	TMA CMA	21 days 14 days
Services Excluded From Price Cap Regulation	IMA TMA	45 days 21 days
Market Area Classification	Any	21 days
Other Tariff Filings	IMA TMA CMA	21 days 21 days 14 days

Carriers typically do not burden their tariffs with the technical details associated with their services. To promote wider disclosure of important network assumptions, the current requirement for waivers of Part 61.74 of the rules to reference technical publications should be eliminated.

Internal company cost and demand information is proprietary. The LECs' competitors do not make their internal cost and demand data public. The value of this information on LEC services and markets in the regulatory process must be weighed against the competitive harm caused by its public disclosure. The market is the ultimate "watchdog" of prices in competitive markets. Accordingly, competitively sensitive cost and demand information, to the extent required by the regulatory review process, must be given proprietary treatment.[139] Regulators may need to review appropriate cost and demand support used to justify the prices for some new services introduced in IMAs and TMAs. Because services in competitive markets would be removed from price cap regulation, no cost support should be required for new services introduced in these markets. Thus, in CMAs, no cost or demand support is required.

As long as forecasted revenues for the new service exceed the forecasted incremental costs, the new service should be allowed to take effect. An incremental cost test, which gauges anticipated revenues against anticipated costs, will serve as an effective safeguard against prices that are too low. SWBT notes that even in an IMA or a TMA, the internal company incremental cost data used to establish a price floor is competitively sensitive information. The marketplace and common business sense will effectively preclude suppliers from introducing new services at exceedingly high prices.

C. <u>The USTA Proposal Will Achieve The Proper Goals</u>. (General Issue 2)

The price cap system should be modified to provide proper financial incentives to the LECs to deploy new technologies that advance the opportunity to expand revenues from new services and to reduce the cost of delivering services. Each price cap LEC should be given

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[139] The Commission should not cast the LECs' competitors (CAPs, IXCs, electric utilities, private network providers and others) in the role of regulator given the profound competitive disadvantage caused by public disclosure of the internal company cost and demand data that may be needed to fulfill the regulator's role.

the opportunity to earn from its efforts and to serve its customers in a similar manner as other interstate service providers. For example, the interexchange carriers have deployed digital networks and fiber optic transport facilities because the financial incentives of increased earnings and limited regulatory oversight. Under a pure price cap system, for example, AT&T has been allowed to maximize earnings to fund the rapid modernization of its network.[140] The intent of the Communications Act to increase consumer welfare through deployment of an efficient communications network is advanced by a system that provides the LECs the same incentives that have proved effective for AT&T.

As demonstrated in the USTA Comments being filed in this proceeding, the USTA proposal will best satisfy the appropriate goals for the LEC price cap performance review.[139] The econometric evidence fully supports adoption of the proposal.[140]

IV. CHANGES FROM THE LEC PRICE CAP REVIEW WILL IMPACT OTHER PROCEEDINGS. (Baseline Issue 12)

A. Depreciation Reform Should Also Occur.

The Commission has stated that the presence of earnings sharing and the LECs' presumed ability to manipulate earnings precluded it from granting the price cap LECs control

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[140] AT&T's interstate earnings have averaged 13.19% over the past three years, while SWBT's interstate earnings have averaged 11.78% over the same period. Had SWBT been able to record regulated depreciation expense at the same pace as AT&T, its interstate earnings would have been only 7%. See Section II.2.b. above.

[139] Price Cap Performance Review for Local Exchange Carriers, Comments of the United States Telephone Association, CC Docket No. 94-1, released May 9, 1994, pp. 43-100. "Economic Benefits of LEC Price Cap Reforms," by Professor Robert G. Harris.

[140] Id., "The Economic Impact of Revising the Interstate Price Cap Formula for the Local Exchange Carriers," the WEFA Group.